

STATE OF CALIFORNIA
Budget Change Proposal - Cover Sheet
DF-46 (REV 08/17)

Fiscal Year 2018-19	Business Unit	Department Franchise Tax Board	Priority No. 2
Budget Request Name 7730-001-BCP-2018-A1		Program 6280	Subprogram 6280010/6280019

Budget Request Description
Cannabis

Budget Request Summary

The Franchise Tax Board (FTB) requests \$193,000 General Fund augmentation in 2018-19 and \$247,000 General Fund in 2019-20 and ongoing to handle the increase of cash being delivered for tax payments due to the new adult-use cannabis law. Revenue associated with cash payments is anticipated to be \$19 million in 2018-19 and \$23.5 million ongoing. FTB will collaborate with California Department of Tax and Fee Administration (CDTFA) to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers. This will minimize costs and provide convenience to taxpayers.

Requires Legislation <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	Code Section(s) to be Added/Amended/Repealed	
Does this BCP contain information technology (IT) components? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No <i>If yes, departmental Chief Information Officer must sign.</i>	Department CIO	Date

For IT requests, specify the project number, the most recent project approval document (FSR, SPR, S1BA, S2AA, S3SD, S4PRA), and the approval date.

Project No. Project Approval Document: Approval Date:

If proposal affects another department, does other department concur with proposal? ☒ Yes ☐ No
Attach comments of affected department, signed and dated by the department director or designee.

Prepared By Department Director	Date	Reviewed By Agency Secretary	Date
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Pending Board Approval

Department of Finance Use Only

Additional Review: ☐ Capital Outlay ☐ ITCU ☐ FSCU ☐ OSAE ☐ CALSTARS ☐ Dept. of Technology

PPBA Date submitted to the Legislature

A. Budget Request Summary

The Franchise Tax Board (FTB) requests \$193,000 General Fund augmentation in 2018-19 and \$247,000 General Fund in 2019-20 and ongoing to handle the increase of cash being delivered for tax payments due to the new adult-use cannabis law. Revenue associated with cash payments is anticipated to be \$19 million in 2018-19 and \$23.5 million ongoing. FTB will collaborate with California Department of Tax and Fee Administration (CDTFA) to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers. This will minimize costs and provide convenience to taxpayers.

B. Background/History

The cultivation, sales and use of medical cannabis has been legal in California for approximately 20 years. In 1996, voters approved Proposition 215, which legalized the use of medical cannabis in California. In 2015, in an effort to regulate the industry, the Medical Marijuana Regulation and Safety Act was established. In 2016 the Adult Use of Marijuana Act was established by the voters of California with Proposition 64 to be implemented by January 1, 2018. With the passage of proposition 64, cannabis and cannabis related businesses can organize as for profit businesses and are subject to the associated income tax. Prior to January 1, 2018, cannabis related businesses (CRBs) were required to organize and file tax returns as non-profit cooperatives or collaboratives and had minimal tax liabilities. Since CRBs are not identified by a unique standard industry code, FTB is unable to accurately say how many CRBs are operating in California, how many file tax returns, how much tax they pay or how they pay their liabilities (cash, check, credit card, etc.). The three California taxing agencies impacted by CRBs are the CDTFA handling sales, use, and excise taxes, the Employment Development Department (EDD) handling payroll taxes and the FTB handling income tax. The Bureau of Cannabis Control (BCC) is the lead agency in developing regulations for medical and adult-use cannabis. The BCC is responsible for licensing retailers, distributors, testing labs and microbusinesses.

Cannabis remains illegal under federal law, (Controlled Substances Act (CSA) provides that the cultivation, possession, and distribution of marijuana is illegal, 21 U.S.C. §801 et. seq.) and as such cannabis businesses generally have difficulty opening bank accounts, obtaining credit cards or otherwise use the federally regulated banking system. This is also true for many other businesses that support the cannabis industry with supplies and services.

Regardless of the application of federal or state law as it relates to cannabis as a product or activity, income from cannabis sales are taxable to the State of California. For purposes of the Revenue and Taxation Code (RTC), gross income includes illegally obtained funds. (RTC sections 17041 and 24271 incorporating by reference Section 61 of the Internal Revenue Code and *James v. U.S.* (1961) 366 U.S. 213, 218.) FTB is required to administer and enforce the RTC which requires taxpayers to pay tax, interest and penalties to FTB and FTB to refund overpayments to taxpayers. (RTC sections 19501, 19005 and 19302.)

Cash payments made by CRBs will begin increasing after January 2018, with a more significant increase anticipated after July 2018. This is due to legalization of adult-use cannabis and the new businesses that will be formed to support that industry. CRBs are generally unable to participate in the financial markets, and must pay their taxes using cash. Cash transactions are inherently risky as cash attracts crime, is difficult to track, is time consuming to count, bulky to store and secure, and can be counterfeited.

The State has been diligently working on determining a state wide cash acceptance solution for all departments receiving cash from CRBs as required under Business and Professions Code Section 26180.5 which reads:

No later than January 1, 2018, the Secretary of Business, Consumer Services, and Housing or his or her designee shall initiate work with the Legislature, the Department of Consumer Affairs, the Department of Food and Agriculture, the State Department of Public Health, and any other related departments to ensure that there is a safe and viable way to collect cash payments for taxes and fees related to the regulation of cannabis activity throughout the state.

While the hope is that a viable federal or state solution to managing California's cannabis cash is on the horizon, none is immediately available. FTB's objective is to provide a safe, secure environment for state employees and customers while conducting business in the most efficient and cost effective manner, providing the best customer experience for all FTB customers.

CDTFA already has infrastructure in place to accept cash payments. FTB will collaborate with CDTFA to leverage this infrastructure to accept FTB's cannabis cash payments. This avoids duplicating costs for fortifying FTB offices in a secure manner necessary to accept cash payments of this nature. This provides improved customer service for taxpayers, allowing the taxpayer to make their sales, use, and income tax payments at the same location. Only cash payments over \$5,000 will be accepted. Payments that are less than \$5,000 will not be accepted in cash and the taxpayer must make other arrangements such as money orders.

Workload History

Workload Measure	2012-13	2013-14	2014-15	2015-16	2016-17 ¹	2017-18
Cannabis Cash Deposits	NA	NA	NA	NA	30	240

¹Medical Cannabis cash collected in 2016-17.

C. State Level Considerations

FTB expects to see an increase in cash payments beginning in January 2018, with a more significant increase anticipated after July 2018, as more businesses become tax compliant and adult-use cannabis businesses begin to receive their state licenses and make estimate payments. FTB expects a steady increase in the number of cash based taxpayers beginning 2019 as new cannabis related businesses file their first tax returns and pay their liabilities. FTB has reviewed the impact to the state of Washington and Colorado. The state of Washington has a population of approximately 7.3 million people and supports 1,900 cannabis businesses. This is about 3,800 residents per cannabis business. Colorado has a population of 5.5 million and supports 1,600 cannabis businesses, or 3,400 residents per cannabis business. Based on the information from Washington and Colorado, FTB is estimating the following number of cannabis businesses the next three years:

	2018-19	2019-20	2020-21
Total businesses	4,600	5,500	5,500
Compliant businesses (70%)	3,220	3,850	3,850
Cash businesses (45%)	1,449	1,733	1,733
Payments per quarter	1,449	1,733	1,733
Total annual payments	5,796	6,932	6,932
Annual payments over \$5,000 (17%)	986	1,179	1,179

The volumes assume a 70% compliance rate among the cannabis businesses. Studies of the industry have shown a tax compliance rate of just over 40% with medicinal marijuana. With the new regulatory framework, licensing, and tracking, we are anticipating cannabis compliance to improve to 70%. In addition, these volumes assume 55% of the cannabis businesses will have bank accounts. In 2016, approximately 30% of cannabis businesses had bank accounts, this improved to 69% in 2017. However, with recent changes at the federal level, we are anticipating the number of cannabis businesses with bank accounts to decrease slightly to 55%.

This proposal supports FTB's mission to help customers file and pay timely and to fund services important to Californians. This proposal also aligns with the value to deliver excellent products and services that meet the customers' needs.

D. Justification

Cash management as a result of Proposition 64 is one of the major challenges for all California agencies interacting with cannabis related businesses. Until there is a broader state or federal solution that facilitates the safe and efficient processing of cash or allows for CRBs to participate in the financial markets, state

departments need to find other options for cash management in the near term that provide safe and efficient transactions.

FTB will collaborate with CDTFA to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers.

CDTFA already has a cash collection system in place and they are equipped to collect cannabis cash payments of this nature. For security purposes, this cash collection process is not published on the CDTFA webpage.

FTB will enter into an Interagency Agreement (IA) with CDTFA to accept cannabis cash payments for income taxes from taxpayers.

Taxpayers must have an approved exemption to make an appointment for a cash payment. Appointments are mandated and payments will not be accepted without one. FTB will work with CDTFA to schedule appointments for the taxpayer to meet to collect the cash payments. Taxpayers apply and need to receive an exemption approval annually in order to qualify.

CHP must be present during the cash acceptance hours to ensure a safe and secure environment for both staff and taxpayers.

For FTB payments, the taxpayer must identify the taxpayer name for the account, account number, payment amount, payment type (estimate, bill or extension payment) and whether it is a personal income tax (PIT) or corporation payment. Deposits are then made directly into FTB account and the payment information is sent overnight to FTB's Accounting Section.

California Cannabis Tax Fund

At this time, FTB is not referenced as an eligible partner allowing costs to be covered by the California Cannabis Tax Fund established under SB 94. Because FTB is not currently included in this cost covering agreement, FTB costs will need to be covered by the General Fund.

E. Outcomes and Accountability

It is the mission of FTB to help taxpayers file timely, accurate tax returns and pay the correct amount to fund services important to Californians. It is the responsibility of FTB to ensure payments can be received from taxpayers choosing to pay their required income tax payments in cash.

FTB will coordinate with CDTFA to determine which days taxpayer cash can be accepted.

Projected Outcomes

Workload Measure	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Cannabis Cash Deposits	240	986	1,179	1,179	1,179	1,179

F. Analysis of All Feasible Alternatives

Alternative #1

Approve \$193,000 GF in 2018-19, and \$247,000 GF in 2019-20 and ongoing to fund resources to partner with CDTFA to collect cannabis cash payments.

This alternative will allow FTB to partner with CDTFA to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers.

Alternative #2

Approve \$193,000 in 2018-19, and \$247,000 in 2019-20 and ongoing from the California Cannabis Tax Fund to fund resources to partner with CDTFA to collect cannabis cash payments.

This alternative will allow FTB to partner with CDTFA to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers. By authorizing the funding from the California Cannabis Tax Fund, this alternative avoids costs to the General Fund.

Alternative #3

Approve \$2 million in 2018-19, and \$768,000 in 2019-20 and ongoing to retrofit FTB field offices to provide a safe and secure environment for state employees and customers to collect cash payments.

This alternative will provide funding for the purchase of high speed cash counter machines, CHP security contracts, armored car service and creation of cash rooms for all public facing field offices.

Alternative #4 – Do not approve request.

By denying the request FTB will not have the funds needed to collaborate with CDTFA to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from the taxpayers or safely collect cash payments at FTB's field offices. This will create roadblocks for cannabis businesses as they seek to be compliant with filing and payment of taxes. Also, the inability to provide a reasonable process for the cannabis businesses will in all likelihood contribute to lost revenue to the state and will substantially increase the risk of robbery and acceptance of counterfeit money.

G. Implementation Plan

June 2018 – Finalize Interagency Agreement with CDTFA.

H. Supplemental Information

Consultant and Professional Services - Interagency Agreement with CTFA

I. Recommendation

FTB recommends the approval of Alternative #1 to collaborate with CDTFA to leverage the infrastructure CDTFA has in place to collect cannabis cash payments from taxpayers. This alternative is the most cost effective and provides safe and secure locations for the taxpayer to deliver cash payments.

7730-001-BCP-2018-A1

	CY	BY	BY+1	BY+2	BY+3	BY+4
Positions						
Permanent	0.0	0.0	0.0	0.0	0.0	0.0
Temporary	0.0	0.0	0.0	0.0	0.0	0.0
Exempt	0.0	0.0	0.0	0.0	0.0	0.0
Board	0.0	0.0	0.0	0.0	0.0	0.0
Total Positions	0.0	0.0	0.0	0.0	0.0	0.0
Salaries and Wages						
Earnings - Permanent	0	0	0	0	0	0
Earnings - Temporary	0	0	0	0	0	0
Earnings - Statutory/Exempt	0	0	0	0	0	0
Overtime, Holiday, Other	0	0	0	0	0	0
Total Salaries and Wages	\$0	\$0	\$0	\$0	\$0	\$0
Staff Benefits						
Dental Insurance	0	0	0	0	0	0
Disability Leave	0	0	0	0	0	0
Health Insurance	0	0	0	0	0	0
Life Insurance	0	0	0	0	0	0
Medicare Taxation	0	0	0	0	0	0
OASDI	0	0	0	0	0	0
Retirement	0	0	0	0	0	0
Unemployment Insurance	0	0	0	0	0	0
Vision Care	0	0	0	0	0	0
Workers' Compensation	0	0	0	0	0	0
Staff Benefits - Other	0	0	0	0	0	0
Total Staff Benefits	0	0	0	0	0	0
Total Personal Services	\$0	\$0	\$0	\$0	\$0	\$0
Operating Expenses and Equipment						
General Expense	0	5,000	1,000	1,000	1,000	1,000
Printing	0	0	0	0	0	0
Communications	0	0	0	0	0	0
Postage	0	0	0	0	0	0
Insurance	0	0	0	0	0	0
Travel	0	0	0	0	0	0
Training	0	0	0	0	0	0
Facilities Operations	0	0	0	0	0	0
Utilities	0	0	0	0	0	0
Consulting and Professional Services	0	188,000	246,000	246,000	246,000	246,000
Departmental Services	0	0	0	0	0	0
Consolidated Data Centers	0	0	0	0	0	0
Information Technology	0	0	0	0	0	0
Central Administrative Services	0	0	0	0	0	0
Office Equipment	0	0	0	0	0	0
Other	0	0	0	0	0	0
Unclassified/Special Adjustment	0	0	0	0	0	0
Total Operating Expenses and Equipment	\$0	\$193,000	\$247,000	\$247,000	\$247,000	\$247,000
Total Budget Request	\$0	\$193,000	\$247,000	\$247,000	\$247,000	\$247,000
Fund Source - State Operations						
General Fund	0	193,000	247,000	247,000	247,000	247,000
Federal Funds	0	0	0	0	0	0
Other/Special Funds	0	0	0	0	0	0
Reimbursements	0	0	0	0	0	0
Total State Operations Expenditures	\$0	\$193,000	\$247,000	\$247,000	\$247,000	\$247,000
Fund Source - Local Assistance						
General Fund	0	0	0	0	0	0
Federal Funds	0	0	0	0	0	0
Other/Special Funds	0	0	0	0	0	0
Reimbursements	0	0	0	0	0	0
Total Local Assistance Expenditures	\$0	\$0	\$0	\$0	\$0	\$0